(17)

No. 92-1074

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

JOHN HANCOCK MUTUAL LIFE
INSURANCE COMPANY,

Petitioner,

v.

HARRIS TRUST AND SAVINGS BANK,
as Trustee of the Sperry Master Retirement Trust No. 2,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

HOWARD G. KRISTOL
Counsel of Record
ROBERT M. PEAK
JEFFREY N. LEIBELL
Reboul, MacMurray, Hewitt,
Maynard & Kristol
45 Rockefeller Plaza
New York, New York 10111
(212) 841-5700
Attorneys for Petitioner

ROSALIE A. HAILEY
John Hancock Mutual
Life Insurance
Company
RICHARD J.J. SCAROLA
Of Counsel

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Petitioner John Hancock Mutual Life Insurance Company ("Hancock")[1] submits this Reply Brief in response to the Brief for Respondent Harris Trust and Savings Bank ("Harris Trust") and to the briefs *amicus curiae* filed in support of Respondent.[2]

[1] The list of Parties provided in the Brief for Petitioner pursuant to Rule 29.1 continues to be correct as of the date hereof.

[2] References to the Brief for Petitioner and to the Brief for Respondent are cited as "Pet. Br." and "Resp. Br.", respectively, followed by the page number.

(*Footnote continued*)

Argument

GAC 50 IS IN ITS ENTIRETY A "GUARANTEED BENEFIT POLICY" WITHIN THE MEANING OF ERISA § 401(b)(2)

The core function of insurance is the spreading of risk among many policyholders through the pooling of insurance premiums. To that end, an insurance company commingles and invests premiums in its General Account and uses the resulting principal and income to satisfy its obligations to its policyholders. Payment of those obligations is secured by all the assets of the General Account. Policyholders, including pension plans, do not have an interest in any specific assets held by the insurer, but receive a guarantee that the company will pay the contractually agreed benefits. Every State has adopted a comprehensive regulatory scheme to ensure the solvency of insurers and the equitable, non-discriminatory treatment of all policyholders.

The fundamental question in this case is whether ERISA § 401(b)(2), 29 U.S.C. § 1101(b)(2) (1988), should be construed to supersede these long-standing arrangements. Harris Trust's brief asserts that an unspecified portion of Hancock's General Account assets, though supporting obligations to a broad range of policyholders, should be considered assets belonging exclusively to the Sperry Plan and that ERISA requires Hancock to manage these unidentified assets "solely in the interest of" that plan. Harris Trust's argument has no basis in the language or purpose of section 401(b)(2).

Relying inappropriately on decisions of this Court under the federal securities laws, Harris Trust argues that GAC 50 should

References to the briefs *amicus curiae* filed in support of Petitioner by the United States, the State of New York and the Commonwealth of Massachusetts (the "State Insurance Commissioners"), the American Council of Life Insurance and the Life Insurance Council of New York are cited as "US Br.", "NYMA Br.", "ACLI Br." and "LICONY Br.", respectively, followed by the page number. References to pages of the Appendix included in the Petition for a Writ of Certiorari, the Joint Appendix, and the Appendix to the Brief for Petitioner are cited as "PA-", "JA-", and "A-", respectively, followed by the page number.

be considered an investment vehicle, not an insurance policy. But GAC 50 is a traditional General Account insurance product. In exchange for the premiums paid by Harris Trust, Hancock assumes substantial risks, including the unconditional guarantee of payment of pension benefits and a guaranteed rate structure under which additional annuities can be purchased by the Sperry Plan.

Harris Trust's construction of section 401(b)(2) incorrectly assumes that an insurer is able to manage separately a portion of its General Account assets. GAC 50 does not have any specific assets or funds associated with it to which ERISA's fiduciary rules could be applied. Although the contract provides for an accounting of the premiums received, benefits paid and other transactions affecting the contract, the only "funds" associated with GAC 50 are the entirety of the assets in Hancock's undivided General Account. The so-called "free funds" under the contract are not funds at all, but merely a colloquial expression of the amount by which the book value of the contract at any time exceeds the computed value of existing guaranteed benefits. Because the "free funds" under GAC 50 are not assets, Harris Trust's argument that the "free funds" can and, under ERISA's fiduciary rules, must be managed for the benefit of the Sperry Plan is insupportable.

The Department of Labor ("DOL") rejects Harris Trust's position. It has consistently construed section 401(b)(2) to exclude from ERISA's fiduciary provisions General Account contracts like GAC 50 that provide solely for fixed guaranteed benefits. That construction, with which Hancock concurs, recognizes that General Account assets cannot be managed solely in the interest of any one policyholder. The DOL's interpretation is both correct and entitled to deference.

A. *Harris Trust's Construction of Section 401(b)(2) Is Inconsistent with the Statutory Language.*

Harris Trust, like the court below, incorrectly assumes that there are discrete assets assigned to GAC 50 and that the contract can be bifurcated into "guaranteed" and "non-guaranteed"

portions. Harris Trust contends that a group annuity contract does not "provide for" guaranteed benefits within the meaning of section 401(b)(2) unless all "funds" held under the contract have been used to purchase fixed guaranteed benefits. Resp. Br. at 18. In addition, Harris Trust argues that GAC 50 is not a guaranteed benefit policy to the extent of its "non-guaranteed portion," because the "free funds" do not bear a fixed rate of investment return to the plan. *Id.* at 20-25.[3] Harris Trust's construction of section 401(b)(2), however, finds no support in the statute's text.[4]

1. *GAC 50 "Provides for" Guaranteed Benefits in Its Entirety.*

It is undisputed that all of the funds credited to GAC 50 may be used, at the contractholder's election, to provide guaranteed benefits. Resp. Br. at 4. According to Harris Trust, however, the "guaranteed benefit policy" provision applies only to the extent of the fixed guaranteed benefits that the contractholder has already purchased. This construction ignores the common, ordinary meaning of the phrase "provides for." The principal definitions of "provide" are "[t]o furnish; supply; to make

[3] It is not clear whether Harris Trust takes the position that, if there were a guaranteed rate of investment return with respect to the so-called "free funds," GAC 50 would be a "guaranteed benefit policy" in its entirety. It is also not clear, therefore, whether Harris Trust is abandoning the Second Circuit's reasoning, under which assets held under a contract providing either guaranteed benefits or a fixed rate of return are not subject to ERISA's fiduciary requirements (*see* PA-10). Earlier, Harris Trust took the position that a guaranteed investment contract (or "GIC"), which typically has a guaranteed rate of return, is a "guaranteed benefit policy" (JA-86, JA-102).

[4] Harris Trust devotes substantial attention in its Brief to the "to the extent that" phrase in section 401(b)(2)(B). *See, e.g.*, Resp. Br. at 11-14. There is no dispute, however, that a contract is a "guaranteed benefit policy" only "to the extent that" it "provides for benefits the amount of which is guaranteed by the insurer." ERISA § 401(b)(2)(B), 29 U.S.C. § 1101(b)(2)(B) (1988). Contrary to Harris Trust's assertions, Resp. Br. at 12-14, neither Hancock nor the DOL contends that section 401(b)(2) insulates all General Account assets from "plan assets" treatment. *See* Pet. Br. at 26-29; US Br. at 16-19. The question here is whether GAC 50 in its entirety satisfies the "provides for" test.

available." *The American Heritage Dictionary* 1458 (3d ed. 1992). *See* US Br. at 16. When "provide" is used in conjunction with "for," the principal meaning of that phrase is "to take measures in preparation." *The American Heritage Dictionary*, *supra*, at 1458.[5] The natural construction of section 401(b)(2)(B), therefore, is that a General Account contract is a "guaranteed benefit policy" to the extent that the amounts credited to the contract can be used, immediately or in the future, to provide fixed guaranteed benefits. US Br. at 16. Harris Trust's misreading of the "provides for" language inappropriately narrows the scope of that section.

Harris Trust's further contention that to satisfy section 401(b)(2) there must be a guaranteed investment return with regard to the "free funds" is created out of whole cloth. It finds no support whatever in the text of ERISA, nor is such a requirement mentioned or even alluded to in the statute's legislative history. Section 401(b)(2) defines a "guaranteed benefit policy" with reference to "benefits"— used everywhere in ERISA to mean benefit payments to plan participants and beneficiaries — not with reference to an investment return (or any other form of payment) to the plan. Pet. Br. at 23-25; US Br. at 16.

2. ***The Federal Securities Laws Decisions Cited by Harris Trust Are Inapposite.***

Harris Trust predicates its investment return requirement on its reading of *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967), *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ("*VALIC*"), and other cases that construe the exemption

[5] In its construction of section 401(b)(2), Harris Trust distorts the meaning of the "provides for" language by reading the section as if it requires that "benefits have been guaranteed." Resp. Br. at 19 (the first sentence of § 401(b)(2)(B) is "designed to limit the exemption to that portion of a contract under which benefit payments were guaranteed") (emphases omitted). By its steadfast misreading of the "provides for" phrase, it evades the phrase's most common usage, *viz.*, to "make provision." *See Webster's Third New International Dictionary* 1827 (1986); *Webster's New International Dictionary* 1994 (2d ed. 1959). GAC 50 indisputably "makes provision" for guaranteed benefits to the full extent of the contract's book value.

of "insurance" from the registration requirements of the federal securities laws.[6] Resp. Br. at 17, 20-25. Those laws contain a specific treatment of insurance crafted by Congress to address the purposes and policies inherent in the federal scheme of securities regulation. ERISA serves very different purposes.[7]

In the federal securities laws, Congress focused on the nature of the relationship between the issuer and the contractholder to determine whether a variety of products constituted "insurance" for purposes of federal securities regulation. *United Benefit* and *VALIC* considered whether variable annuities were "insurance" by analyzing the transfer of investment risk from the insured to the insurance company, *i.e.*, whether investment return to the contractholder was guaranteed by the insurer or variable based upon the contract's participation in the insurer's investment experience. *United Benefit*, 387 U.S. at 208; *VALIC*, 359 U.S. at 71-72. That analysis has no relevance, however, to ERISA's section 401(b)(2), because Congress defined a "guaranteed benefit policy" by reference to whether the benefits paid to plan participants were guaranteed, not whether the contractholder bears investment risks. *See Mack Boring and Parts Corp. v. Meeker Sharkey Moffitt*, 930 F.2d 267, 272-73 (3d Cir. 1991).[8]

[6] In *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mut. Life Ins. Co.*, 698 F.2d 320 (7th Cir. 1983), the Seventh Circuit, relying upon *United Benefit* and *VALIC*, held that the insurance contract in issue was not a "guaranteed benefit policy" under section 401(b)(2), because, except for a modest interest guarantee, it was credited with a variable investment return on the funds not yet used to purchase annuities. *Id.* at 324-27. *Peoria Union* is neither sound authority nor substantively correct. Pet. Br. at 25 n.42.

[7] In *United Benefit*, the Court stated that it was a "difficult" question whether the Investment Company Act regulations, which "are substantive and go well beyond the disclosure requirements of the Securities Act" would also apply to the product in question. *United Benefit*, 387 U.S. at 208. ERISA's fiduciary provisions similarly impose "substantive" regulations. The Court expressly held in *United Benefit* that its decision could not be extended to other contexts, particularly with respect to a contract issued by a company that "in the main is an insurance company." *Id.* at 212.

[8] In addition, unlike GAC 50, the contracts at issue in those cases involved "variable" annuities and the assets underlying the contracts were invested in

(Footnote continued)

3. *GAC 50 Is Not an Investment Vehicle.*

As a predicate to its misplaced *United Benefit* analysis, Harris Trust mischaracterizes GAC 50, asserting that the contract is an "investment vehicle" under which there are no risks transferred from the insured to the insurer. Resp. Br. at 24. That issue is irrelevant, however, to the proper construction of the "guaranteed benefit policy" provision, and, in any event, Harris Trust's characterization is not correct.

As the district court found in *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 722 F. Supp. 998 (S.D.N.Y. 1989) ("*Harris I*"), substantial insurance risks are assumed by Hancock under GAC 50 (PA-53 to PA-56). Most importantly, Hancock has guaranteed benefits to participants and beneficiaries who have been designated by the Plan to receive such benefits and is obligated to pay those benefits unconditionally, irrespective of actual investment and mortality experience and the book value of the contract (PA-54; JA-85, JA-89, JA-91, JA-122, JA-172). Moreover, Hancock provides a guarantee of principal and of the risk charges applicable to investment income apportioned to GAC 50 (PA-55; JA-88, JA-91, JA-102, JA-132 to JA-133).

In addition, Hancock is obligated under GAC 50 to the full extent of the "free funds" to provide additional guaranteed benefits, at Harris Trust's option, at annuity purchase rates contained in the contract.[9] As the district court held in *Harris I*, Hancock assumed substantial risks under the contract with

Separate Accounts. *United Benefit*, 387 U.S. at 208; *VALIC*, 359 U.S. at 69-70. Moreover, the contract in *United Benefit* clearly had separate phases over time, *United Benefit*, 387 U.S. at 205-06, and there was an identifiable period during which, the Court found, there was little transfer of risk. *Id.* at 208-09.

[9] Upon the purchase of additional guaranteed benefits under the contract (i) the computed value of existing guaranteed benefits (*i.e.*, the Liabilities of the Fund) is increased by an amount equal to the computed value (*i.e.*, the purchase price) of the newly purchased benefits and (ii) the amount of the contract's "free funds" is decreased by a corresponding amount. Neither the book value of the contract (*i.e.*, the Pension Administration Fund) nor any General Account assets are affected in any way by such a transaction.

regard to the "free funds" by granting Harris Trust the right to provide annuities to newly eligible employees or additional groups of employees at guaranteed rates. *Harris I* (PA-56).[10] The existence of so-called "free funds" under the contract, therefore, does not eliminate Hancock's risk or transform GAC 50 from an insurance contract into an investment vehicle.[11]

Despite the district court's finding, Harris Trust argues in this case for the first time that, since Hancock could change the annuity purchase rates after December 31, 1972, it assumed no risk with respect to the "free funds." Harris Trust misrepresents the contract in claiming that the rates could be changed unilaterally by Hancock at any time that Harris Trust sought to purchase additional annuities. Resp. Br. at 4, 5, 15-16, 24. Under GAC 50, beginning with the year 1973, Hancock could modify the rates for future purchases by giving Harris Trust at least 90 days' advance written notice prior to January 1 of each year (JA-176). If the rates had been changed, Hancock would have been obligated to apply those rates whenever Harris

[10] The contractholder's right to purchase additional guaranteed benefits at rates fixed in the contract permits the contractholder to shift the risk of future interest, mortality and expense developments to the insurer. Kenneth Black, Jr., & Harold D. Skipper, Jr., *Life Insurance* 497 (11th ed. 1988). Harris Trust, citing Dan M. McGill & Donald S. Grubbs, Jr., *Fundamentals of Private Pensions* 564 (6th ed. 1989), asserts that Professor McGill "acknowledges that optional purchase provisions in IPG contracts like GAC 50 are no more than a *pretense*." Resp. Br. at 16 (emphasis in original). The authors, however, "acknowledge" no such thing. In the passage cited by Harris Trust, the authors explicitly describe "investment only arrangements, such as the guaranteed income contract" and point out that, "while written in the form of an IPG contract," such contracts often "make no pretense of offering annuities and . . . contain[ ] no reference to annuity purchase rates." McGill & Grubbs, *supra*, at 564. It is clear from the text that the authors are not describing or referring to conventional IPG contracts like GAC 50.

[11] Harris Trust attempts to make much of the 1988 amendment to GAC 50 by which the sum of $53 million was transferred from GAC 50 by Harris Trust without termination of the contract's Pension Administration Fund ("PAF"). Resp. Br. at 6. Despite Harris Trust's obfuscation, it is clear that Harris Trust, as contractholder, always had the unilateral right to transfer the amount of the "free funds," or book value excess, subject to a market value adjustment

(*Footnote continued*)

Trust sought to purchase additional guaranteed benefits.[12] Contrary to Harris Trust's assertions, therefore, Hancock has always been at risk with respect to any such additional annuity purchases. *See Harris I* (PA-54 to PA-56).

B. *The DOL Has Correctly and Consistently Interpreted Section 401(b)(2).*

The DOL has advised the Court that it agrees with Hancock that a "guaranteed benefit policy" is a "contract pursuant to which an insurer holds assets in its general account to guarantee the payment of fixed annuities." US Br. at 9. Harris Trust urges, however, that the DOL's construction of section 401(b)(2) "cannot be squared with the statutory language," rests upon a speculative reading of the legislative history and is inconsistent with its previous pronouncements. Resp. Br. at 30-33. The DOL's interpretation, however, is the only construction of section 401(b)(2) that is fully in accord with the text of the statute and its legislative history. It is entitled, therefore, to deference by this Court.

1. *ERISA's Legislative History, Though Sparse, Supports the DOL's Construction.*

The DOL correctly points out that the term "guaranteed benefit policy" was coined by the ERISA Conference Committee. US Br. at 11-12. It had no antecedents in the House or Senate bills, and the only reference to that provision in the Conference

(JA-101). Pet. Br. at 9 n.18. Harris Trust now claims that, absent the amendment, termination of the PAF would have been the necessary consequence of such a transfer. Hancock disagrees with that conclusion, but whether or not Harris Trust is correct, a contract provision relating to the transfer of the market value equivalent of the "free funds" is not in any way relevant to the issue of whether GAC 50 "provides for" guaranteed benefits.

[12] In fact, Hancock has never changed the annuity purchase rates (JA-101). Even if Hancock had annually changed the rates, however, it would continue to bear sufficient risk to satisfy the *United Benefit* and *VALIC* holdings, assuming that the analysis in those cases were relevant. *Cf. Associates in Adolescent Psychiatry S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 567-68 (7th Cir. 1991), *cert. denied*, 112 S. Ct. 1182 (1992) (insurance policy was exempt from the securities laws and was a "guaranteed benefit policy" when insurance company guaranteed annual rate of interest at beginning of each year).

Report is at best ambiguous. US Br. at 20-21. The DOL explains that the "guaranteed benefit policy" provision was inserted in place of a provision in the final Senate bill that explicitly exempted all General Account assets from the fiduciary provisions.[13] The DOL has offered the only plausible explanation of this development in the Conference Committee — that Congress intended a tightening of the explicit exemption contained in the Senate bill by excluding the possibility that variable annuities could be immunized from the fiduciary rules by being written on an insurer's General Account. *See* US Br. at 20. The DOL points out in its Brief that, under the Senate bill, it was theoretically possible for a General Account contract that provided variable benefits to be removed from ERISA's fiduciary requirements. *Id.*

Harris Trust attacks the DOL's explanation of the change on the ground that it is premised on a "potential loophole" that could not have existed. Resp. Br. at 29. Citing Hancock's brief, Pet. Br. at 19, Harris Trust contends that, since the insurance laws of all 50 States require that variable annuities be issued from Separate Accounts, section 401(b)(2) could not have been meant to address the potential problem identified by the DOL. Resp. Br. at 29-30. In fact, Congress' concern was not at all misplaced. In 1952, long before ERISA's enactment, New York enacted special legislation enabling the College Retirement Equities Fund ("CREF"), a companion organization of Teachers' Insurance and Annuity Association of America, to issue variable annuities out of what CREF characterized as its "General Account." 1952 N.Y. Laws 661.[14] In rewriting section 401(b)(2),

[13] The Senate bill provided:

> (*1*) This section shall not apply to -
>
> (1) funds held by an insurance carrier unless that carrier holds funds in a separate account . . . .

H.R. 2, 93d Cong., 2d Sess. § 15 (1974), *reprinted in* 3 Senate Subcomm. on Labor & Pub. Welfare, 94th Cong., 2d Sess., Legislative History of ERISA, 3599, 3781 (Comm. Print 1976) ("Legislative History of ERISA").

[14] The variable annuity contract discussed by the DOL in its Advisory Opinion 78-8A, March 13, 1978 (A-104), was issued in accordance with that statute. *See infra* at 14.

Congress may well have had in mind the possibility that special arrangements relating to insurers' General Accounts might be permitted by state legislatures or state insurance regulators that would undermine the basic policy of the statute that assets supporting variable annuity benefits should be treated as "plan assets."

Harris Trust argues that the Conference Committee's replacement of the blanket exemption in the Senate bill with the "guaranteed benefit policy" provision signaled a dramatic change. Resp. Br. at 12. Harris Trust is correct only insofar as it points out that the Conference Committee changed the language of the Senate bill, but its inference that the change was intended to reject the provision in the Senate bill in favor of a completely different approach is not supported by the legislative history. Quite the contrary, the legislative history, to the extent that it sheds any light on the "guaranteed benefit policy" provision, shows that the final bill was meant to implement the common intent of the Senate and House bills that, to the extent that a group annuity contract provided for fixed benefits, assets in an insurer's General Account would not be subject to ERISA's fiduciary rules.

According to the Staff Summary of Differences between the Senate and House versions of the final bill, H.R. 2,[15] though the House bill did not contain the same or similar language, it embodied the same policy as the Senate bill that assets in the General Account be exempt.[16] The Joint Explanatory Statement

[15] *See* Summary of Differences between the Senate Version and the House Version of H.R. 2 to Provide for Pension Reform (the "Staff Summary"), pt. 3, 93d Cong., 2d Sess. 2 (1974), *reprinted in* 3 Legislative History of ERISA, *supra*, at 5252. The Staff Summary was cited by this Court as authority for construing ERISA in *Nachman Corp. v. Pension Benefit Guaranty Corp.*, 446 U.S. 359, 376 n.24 (1980).

[16] Discussing the Senate position, the Staff Summary stated:

> *Senate Amendment*. - [The fiduciary obligation provisions] do not apply to:
>
> . . .

(*Footnote continued*)

of the Committee of Conference, which "explains the principal differences between the substitute agreed to in the conference and the House and Senate bills," did not identify any such difference with regard to the "guaranteed benefit policy" provision. H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 249, 295-97 ("Conference Report"), *reprinted in* 3 Legislative History of ERISA, *supra*, at 4518, 4562-64.[17]

Certainly, if the Conference Committee intended the dramatic change suggested by Harris Trust, the Conference Report would have addressed the change explicitly. Pet. Br. at 33-35. The only plausible interpretation of this sparse legislative history is the DOL's explanation that Congress intended to tighten the complete exemption for General Account assets contained in the Senate bill by excluding the possibility that variable annuities could be immunized from the fiduciary rules by being written on an insurer's General Account, not to reject the exemption in favor of a completely different approach. *See* US Br. at 20.

2. *The DOL Has Been Consistent in Its Construction.*

Harris Trust contends that the DOL's interpretation of section 401(b)(2) should not be accorded deference, because,

(6) funds held by an insurance carrier unless they are held in a separate account . . . .

Staff Summary, *supra*, at 2. Discussing the House position, the Staff Summary stated:

Although the House bill does not specifically exempt these funds from the fiduciary responsibility rules, *the policy of the House bill is the same.*

Id. at 2 n.3 (emphasis added).

[17] Under the Standing Rules of the Senate and the Rules of the House of Representatives, a joint Senate and House conference committee is prohibited from striking provisions that have been agreed upon by both chambers. For example, the Senate Rules state:

Conferees shall not insert in their report matter not committed to them by either House, nor shall they strike from the bill matter agreed to by both Houses.

(*Footnote continued*)

according to Harris Trust, it is a "recently adopted position first espoused in this Court, and unsupported by prior regulations, rulings, or administrative practices." Resp. Br. at 33. That is simply untrue.

As the DOL states in its Brief, its construction of section 401(b)(2) "was developed contemporaneously with ERISA's enactment and has been followed since that time." US Br. at 11. The DOL also points out that it has never brought any enforcement proceeding or otherwise sought to invoke ERISA's fiduciary provisions in connection with General Account contracts like GAC 50. US Br. at 13.

In its first authoritative pronouncement regarding ERISA in February 1975, Interpretive Bulletin 75-2 (February 6, 1975), 40 Fed. Reg. 31,598, *codified as revised*, 29 C.F.R. § 2509.75-2(b) (1991) ("IB 75-2"), the DOL declared that General Account assets are not to be considered "plan assets" (A-100). Harris Trust argues that IB 75-2 merely addressed application of ERISA's "prohibited transactions" rules; however, no such limitation is stated in IB 75-2. Moreover, the suggestion that such a limitation was intended is contradicted by the DOL's further statement the very next day, in its Advisory Opinion 75-79 (February 7, 1975), which was addressed to the fiduciary provisions generally (A-103). There the DOL reiterated that IB 75-2 "makes clear that when a plan purchases a policy or policies on an insurance company's general assets account, the plan assets consist of the policy, and not the underlying assets of the insurance company" (*id.*). Harris Trust does not mention Advisory Opinion 75-79 in its Brief.[18]

Standing Rules of the Senate, Rule XXVII ("Conference Reports"), § 2; *see also* Rules of the House of Representatives, Rule XXVII ("Conference Reports"), § 3. It would have been impermissible under those rules for the Conference Committee to reject the common intent and design of the bills adopted by the two Houses, and it is extremely unlikely that the Committee would have done so without comment or explanation in the Conference Report.

[18] Harris Trust's argument is essentially that the DOL, contrary to what the DOL now says, construed the phrase "plan assets" differently for application of the fiduciary provisions than for application of the prohibited transactions

(*Footnote continued*)

Harris Trust misreads various other DOL pronouncements from which it suggests that there has been inconsistency in the DOL's position over the years.[19] For example, Harris Trust contends that the DOL expressed the view in its Advisory Opinions 78-8A (March 13, 1978) (A-104) and 83-51A (September 21, 1983) (A-110) that fiduciary duties apply if a contract has a variable investment return component. But the outcome in Advisory Opinion 78-8A turned on the fact that the CREF "general account" contract provided for variable annuities, not variable investment return (A-106). *See also* US Br. at 27.[20] That conclusion is precisely the position taken by the DOL in its Brief here. The issue in Advisory Opinion 83-51A was whether assets in a contract denominated a "separate account" contract would be deemed "plan assets" if the contract provided for fixed obligations in all respects. The DOL concluded that the fiduciary

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provisions. Harris Trust, quoting the court below (PA-13), attempts to support its argument by positing that " '[t]here is no inconsistency in considering certain assets to be plan assets for general fiduciary purposes but not for prohibited transactions purposes.' " Resp. Br. at 34-35. That distinction was rejected by the DOL 18 years ago in Advisory Opinion 75-79. US Br. at 27. As the DOL points out in its Brief, there is no basis in ERISA for defining "plan assets" differently for prohibited transactions than for ERISA's general fiduciary rules; in fact, the language of section 401(b)(2) "nowhere suggests that the [assets supporting a guaranteed benefit policy] may be plan assets for some purposes but not for others." US Br. at 26-27.

[19] Even if the DOL's statements regarding section 401(b)(2) had not always been consistent, inconsistency would provide no basis for not deferring to its position as stated in its Brief. *See Rust v. Sullivan*, 111 S. Ct. 1759, 1769 (1991).

[20] The DOL points out that IB 75-2 states that assets held in General Accounts are not "plan assets" subject to the fiduciary rules, without regard to whether variable or fixed annuities would be provided, because the DOL understood at the time IB 75-2 was issued that, under state law, variable annuities could not be written on a General Account. US Br. at 27. When, in Advisory Opinion 78-8A, the DOL was confronted with a contract that did provide for variable annuities written on what was denominated a "general account" (that of CREF), the DOL clarified its position, indicating that the assets underlying a contract will not be subject to "plan assets" treatment only to the extent that it provides for fixed, rather than variable, benefits. US Br. at 14, 27. That is consistent with the position urged by both the DOL and Hancock in this case. *See id.* at 14.

provisions would not apply (A-112). That opinion, despite the fact that it has no relevance to a General Account contract, is nonetheless in harmony with the DOL's interpretation of the statute. *See* US Br. at 27-28; Pet. Br. at 21 n.35.

Finally, Harris Trust argues that there is significance in the DOL's not having acted upon proposals made over the years by insurance company representatives for a complete exemption of all General Account assets from the definition of "plan assets." The DOL's position, however, has been and is today that assets in an insurer's General Account are excluded from "plan assets" treatment only if the contract in question provides for fixed, rather than variable, benefits. It is not inconsistent that the DOL declined to adopt a broader exemption.

When the DOL adopted its comprehensive "Plan Assets Regulation" in 1986, it expressly stated that the portion of IB 75-2 which dealt with assets placed in an insurance company's General Account was left unaffected. Preamble to Plan Assets Regulation, 51 Fed. Reg. 41,262, 41,278 (1986) (PA-111). In the words of the DOL, the basic principle in IB 75-2 was "reaffirmed," "repromulgated," "reconfirmed" and "reissued" in the Plan Assets Regulation, 29 C.F.R. § 2510.3-101 (1992) (PA-99). US Br. at 9, 11, 13, 14. Its consistent construction of section 401(b)(2) should be given deference by this Court as a thoroughly reasoned interpretation of the statute.

C. *Congress Did Not Intend, Nor Could the Insurance Industry Ameliorate, the Consequences of Section 401(b)(2) as Construed by Harris Trust.*

Harris Trust and its *amici* concede that their construction of section 401(b)(2) will disrupt long-standing General Account practices and create a conflict between federal and state law. *See, e.g.*, Resp. Br. at 38-42. They argue, however, that the legislative history shows that Congress anticipated those consequences and, to the extent that the industry might find it difficult to adjust to ERISA's requirements, empowered the DOL to mitigate the displacements through administrative mechanisms.

1. *There Is No Evidence in ERISA's Legislative History of an Intent to Disrupt Long-Standing Insurance Industry Practices.*

Harris Trust asserts that ERISA's Conference Report "makes clear" that Congress intended "the disruptions which were likely to follow from application of section 401(b)(2) to general accounts." Resp. Br. at 30. Although Harris Trust purports to rely upon the "Conference Report," Resp. Br. at 30, 31, 39, the Conference Report contains no evidence of any such intention. Harris Trust in fact quotes from and cites the Senate Report accompanying the Senate bill, S. Rep. No. 127, 93d Cong., 2d Sess. 32 (1973), *reprinted in* 1 Legislative History of ERISA, *supra*, at 618. Resp. Br. at 11-12, 28. Because the Senate bill explicitly excluded all General Account assets from ERISA's definition of "plan assets" (*see supra* at 9-12), the language quoted by Harris Trust from the Senate Report could only refer to Separate Account practices and could not possibly reflect a Congressional intent to subject General Account practices and regulation to ERISA's fiduciary requirements. The legislative history is devoid of any evidence that Congress contemplated, much less anticipated, any of the disruptions that Harris Trust's construction would produce.

Harris Trust next contends that the authority conferred on the DOL under section 408 to exempt fiduciaries and transactions from ERISA's prohibited transaction rules indicates that Congress understood the hardships that might be caused to insurance companies. Resp. Br. at 39-42. The mere existence of that mechanism, however, is no evidence that Congress had in mind any dislocations that ERISA's fiduciary duties might entail for insurance companies. Moreover, under section 408, the DOL lacks the authority to exempt insurance companies from the general fiduciary provisions of ERISA § 404, 29 U.S.C. § 1104 (1988 & Supp. 1991). Section 408 explicitly states that it applies only to "the restrictions imposed by sections 406 and 407(a)" and does not "relieve a fiduciary from any other applicable provision of this chapter." ERISA § 408, 29 U.S.C. § 1108 (1988).

2. *The Mechanisms Suggested by Harris Trust for Mitigating the Disruptions Would Not Succeed, Nor Would They Eliminate the Inherent Conflict Between Federal and State Law.*

Harris Trust and its *amici* argue that "segmentation" can be used by the industry to ameliorate the burdens of applying ERISA to General Account assets. *See, e.g.*, Resp. Br. at 40-41. Segmentation, however, is only a means of assigning General Account assets for income allocation purposes. *See* ACLI Br. at 23 n.26. Under state insurance law, all General Account assets support, on an unsegregated basis, all General Account liabilities, NYMA Br. at 22-23, and, irrespective of an insurer's income allocation methodology, General Account assets may not be managed under state law "solely in the interest of" any particular General Account policyholder. ACLI Br. 22-23; NYMA Br. at 18-19; LICONY Br. at 14-18. Furthermore, to the extent that ERISA's fiduciary provisions prohibit commingling "plan assets" with other funds, any General Account assets that are deemed to be "plan assets" could not be kept in the General Account, nor could they be used to support any obligation owed by the insurer to other contractholders. Harris Trust's view of ERISA's requirements, therefore, could not be satisfied by any action other than a segregation of assets into an account or accounts separately managed for pension plan contractholders.[21]

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[21] Actual segregation and removal of "ERISA-covered" assets from the General Account, of course, would be contrary to the very nature and purpose of insurance contracts that are backed by the full guarantee of the entire General Account. Such segregation would subject each plan to a greater risk of deviation from expected mortality experience and the higher costs associated with managing small asset pools rather than a single large one. Plans enter into insurance contracts precisely because they allow the transfer and sharing of mortality and investment risk. Although Harris Trust and its *amici* assert that applying ERISA's fiduciary provisions to an insurer's General Account would enhance participants' rights under ERISA, it may actually undermine benefit security. NYMA Br. at 6-7. Moreover, as the State Insurance Commissioners note in their Brief, implementing segregation would involve a cumbersome asset allocation process, provoke litigation and necessitate legislative intervention. NYMA Br. at 25-26.

Harris Trust tries to dispose of the inherent conflict between ERISA and state law by asserting that, to the extent that a conflict develops, state law will be preempted.[22] It provides not a single reference in the legislative history, however, that suggests that Congress anticipated or even considered that ERISA might supplant state regulation of insurance company General Accounts.[23]

As shown in its Brief, Hancock's construction of section 401(b)(2) avoids any conflict between federal law and state law. Pet. Br. at 29-35. Moreover, Hancock's interpretation gives effect to the long-standing federal policy, as expressed in ERISA's preemption saving clause, ERISA § 514(b), 29 U.S.C. § 1144(b) (1988 & Supp. 1991), and the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.* (1988 & Supp. 1991), that the regulation

[22] Harris Trust argues that, as a consequence of ERISA's preemption clause, ERISA § 514, 29 U.S.C. § 1144 (1988 & Supp. 1991), and the Supremacy Clause, ERISA preempts state insurance laws. Resp. Br. at 44-50. Because the construction of section 401(b)(2) urged by Hancock avoids a conflict with state law, Hancock does not believe that the Court need reach the preemption issue discussed in Harris Trust's brief. In addition, Harris Trust misrepresents *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987), as holding that ERISA preempts a state statute regulating the business of insurance when such a statute conflicts with ERISA. The state statute at issue in *Pilot Life* was explicitly found not to regulate the business of insurance and, for that reason, was not saved from preemption under ERISA. *Id.* at 50-52.

[23] Harris Trust asserts that ERISA should be held to apply to the "non-guaranteed" portion of a General Account contract, because state insurance guaranty laws do not apply. Resp. Br. at 14, 16 n.20. That assertion, however, is factually incorrect: Of the 39 jurisdictions (38 States plus the District of Columbia) that specifically address annuity contracts like GAC 50, 19 expressly include the unallocated, or "free funds," portion of the contract within the scope of the guaranty, *see, e.g.*, Ill. Ann. Stat. ch. 215, § 531.03 (Smith-Hurd 1993); Ohio Rev. Code Ann. § 3956.01 (Anderson Supp. 1991); Tex. Ins. Code Ann. § 21.28D (West 1981 & Supp. 1993), while 20 do not. Contrary to Harris Trust's assertions, Resp. Br. at 14 n.16, 16 n.20, 43, New York's statute, N.Y. Ins. Law § 7703 (Consol. 1993), appears to provide coverage for the unallocated portion of contracts like GAC 50. *See* Op. N.Y. Gen. Counsel No. 91-118 (Nov. 4, 1991). In the remaining 11 States, the application of the guaranty laws is unclear. In any event, Harris Trust fails to show that Congress was in any way influenced by the presence or absence of state guarantees in case of insurer insolvency or that the underlying policies of state guaranty laws and ERISA are at all related.

of the business of insurance should be left to the States.[24] *See* Pet. Br. at 30-31. As the State Insurance Commissioners note,

> the decision below would appear to mandate a thorough restructuring of the insurance industry under a federal law that was never intended to interfere with the States' traditional responsibility to regulate that industry.

NYMA Br. at 8.[25] In the absence of any indication in the statutory language or the legislative history that Congress intended to displace state regulation of General Account contracts and practices, section 401(b)(2) should be construed to avoid a conflict between federal and state law. *See Massachusetts v. Morash*, 490 U.S. 107, 119 (1989).

[24] Harris Trust argues that McCarran-Ferguson's reservation of the business of insurance to the States is overridden by section 401(b)(2), because that provision specifically relates to the business of insurance. Resp. Br. at 47-48; *accord*, US Br. at 23 n.13. That provision, however, implements the policy underlying McCarran-Ferguson by excluding the business of insurance from the applicability of ERISA's fiduciary rules. While ERISA does relate to insurance companies and to certain insurance products and practices (*e.g.*, variable annuity contracts and Separate Accounts), ERISA does not "specifically relate" to the "business of insurance," *i.e.*, General Account contracts and practices.

[25] Harris Trust attempts to show that federal and state regulation of General Account activities can co-exist, because insurance companies have been able to adjust to dual regulation with respect to their Separate Account activities. Resp. Br. at 41, 42, 50. That assertion ignores the fundamental differences between the purposes served by insurance company Separate Accounts and General Accounts. Separate Accounts frequently support variable annuities, which are not considered to be within the "business of insurance," and Separate Account investments are not subject to the same comprehensive state regulation applicable to General Account investments. *See* Pet. Br. at 19-21. Moreover, the "pooled" Separate Accounts referred to by Harris Trust (Resp. Br. at 42) are merely mechanisms for pooling the assets of contracts with common investment objectives. Such accounts are different from the General Account, which pools premiums from all lines of business and supports the insurance company's obligations to each of its contractholders to the full extent of the General Account's assets.

Conclusion

The judgment of the Court of Appeals, insofar as it reversed the judgment of the district court dismissing the action, should be reversed.

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Respectfully submitted,

HOWARD G. KRISTOL
Counsel of Record

ROBERT M. PEAK
JEFFREY N. LEIBELL
REBOUL, MACMURRAY, HEWITT, MAYNARD & KRISTOL
45 Rockefeller Plaza
New York, New York 10111
(212) 841-5700

Attorneys for Petitioner

ROSALIE A. HAILEY
John Hancock Mutual Life Insurance Company

RICHARD J.J. SCAROLA

Of Counsel